

April 6, 2009

Ms. Mary Rupp  
Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428

RE: Comments on the Corporate Credit Union System Strategy

Dear Ms. Rupp:

On behalf of Desert Valleys Federal Credit Union, I appreciate the opportunity to comment on the NCUA Board's recent actions designed to stabilize the corporate credit union system. The program, as initially outlined in *NCUA Letter to Credit Unions No. 09-CU-02*, and as further reflected in *NCUA Letter to Credit Unions No. 09-CU-06*, included three primary objectives regarding the corporate system: 1) maintaining liquidity; 2) strengthening capital; and 3) evaluating the existing structure of the corporate system via an Advanced Notice of Proposed Rulemaking (ANPR).

## **Maintaining Liquidity and Strengthening Capital**

The Leagues have significant concerns that the Board's strategy, as crafted and implemented to date, does not fully take into account the serious repercussions to the natural person credit union system and, as a result, to consumers and credit union members. This concern has been further sharpened by NCUA's unexpected actions on March 20, 2009, involving U.S. Central FCU and Western Corporate FCU (WesCorp), which will have an especially pronounced effect on credit unions in the Western states. Further, we believe that the strategy is too narrowly-focused and inflexible in its approach in that it fails to take advantage of several other options and tools available to the Agency that could reduce the costs and impact of the program to credit unions. Our fear is that unless alternative methods and tools are used to soften the staggering financial blow of NCUA's actions, some credit unions may never fully recover from its impact. As a result, we believe there is a real risk that public confidence in credit unions and in the NCUSIF will be negatively affected. However, we are encouraged and cautiously optimistic that the Board's action on March 26, 2009, to ask Congress to form a Corporate Credit Union Stabilization Fund takes an important step towards addressing this concern. By spreading the cost of the stabilization action over as much as seven years, federally-insured credit unions are given the breathing room and flexibility they desperately need.

## **Impact on Desert Valleys Federal Credit Union**

As a result of the 69 percent NCUSIF write off, the accompanying premium assessment to return the NCUSIF capitalization ratio to 1.30 percent, and the write-off of PIC and MCA shares at WesCorp, we will post a negative ROA for 2009. This will be the first time in more than nine years of “Prompt Corrective” recovery that we will post negative income. We will also be required to submit our fifth “Net worth Restoration Plan” during an economic period when the bulk of our limited resources should be focused on the membership and curbing loan losses.

While most credit unions may be able to absorb such losses, and eventually recover (the average net worth ratio for California and Nevada credit unions is estimated to fall to approximately 9.2 percent, which is still well above the level to be considered “well-capitalized”), and all member deposits remain insured up to \$250,000, it is clear that these actions will have a long standing impact on our ability to serve our members. Ultimately, this may cause many credit unions to pull back from providing loans and other financial products and services to working families just when the national and states’ economies need them the most. This has already started happening in some areas and, as credit unions assess the impact the Agency’s actions will have on their operations, will surely accelerate. Some examples that have already been brought to my attention:

- Branch closings. California credit unions made up approximately six percent of the 1,032 credit union branches closed in the U.S. in 2008. Reports from several of our member credit unions indicate that this trend has increased in the first quarter of 2009, and will no doubt soar as all federally-insured credit unions—but especially those in the Western states—reconsider their ability to maintain or open branches under the unplanned-for burden of the Agency’s corporate strategy.
- Fear of long-term interest rate risk keeping credit unions from committing to low loan rates now. This problem compounds the already existing problem faced by many credit unions of already-depressed lending activity. For example, we have heard from a credit union in Nevada that their loan volume has already been virtually shut down; they are funding only 10 percent of applications submitted to them, and have experienced a reduction of 45 percent of funded loans from 2007 to 2008, as well as a reduction of 56 percent in the first two months of 2009. Like many other credit unions, the impact of the write-off, assessment, and corporate capital write-offs will heap even more harmful effects on this credit union and, ultimately, the members it serves.
- Credit unions critically close to seven percent PCA threshold for “well capitalized” turning away deposits in an effort to “manage capital” by not growing. A telling example representative of many other credit unions: a credit union in California’s Central Valley (where we reside) is currently experiencing a loss of \$300,000 per month from loan losses caused by 15 percent unemployment and a 50 percent drop in housing values. In order to maintain a healthy net worth under current PCA requirements, the credit union has to force a two to three million dollar reduction in share balances each month. The effect of the Agency’s actions on this credit union—and many more that are similarly positioned—will be to worsen a situation which is already extremely challenging, and to cause reductions in credit union membership and loan growth.

In addition, we are greatly concerned that the reduction in capital levels that credit unions will experience as a result of NCUA’s actions will lead to a marked contraction in their lending

activity. If, indeed, as Executive Director Marquis stated in NCUA's webinar on March 23, 2009, there is a correlation of 10:1 between capital dollars and lending dollars (i.e., a one dollar reduction in credit union's capital will lead to a \$10 reduction in loan dollars available to members), then we estimate that NCUA's actions—including the write off of PIC and MCA shares at WesCorp—will lead to a reduction in credit union lending *in California and Nevada alone* of approximately **15 billion dollars**.

### **Immediate Actions NCUA Should Take**

First, we urge NCUA to consider permitting credit unions to charge the insurance costs of the stabilization plan directly to Undivided Earnings rather than reflecting it on the Income Statement. We understand that NCUA has stated that Generally Accepted Accounting Principles (GAAP) dictates that credit unions following GAAP book the premium as an expense in the reporting period incurred, and that the Federal Credit Union Act (Act) requires credit unions to file their Call Reports in accordance with GAAP. However, we would like to point out that §202(a)(6)(C)(ii) of the Act further states:

***Board determination.***—*If the Board determines that the application of any generally accepted accounting principle to any insured credit union is **not appropriate**, the Board may prescribe an accounting principle for application to the credit union that is **no less stringent** than generally accepted accounting principles. (emphasis added for discussion)*

Clearly, the Act permits NCUA to substitute its own accounting principles for GAAP when necessary. As the Agency states—accurately—in *Letter to Credit Unions No. 09-CU-02*: “Current financial market conditions... are like nothing experienced since the Great Depression.” Given this stark truth and the effect such conditions will have on credit unions—as well as actions such as the call to temporarily suspend mark-to-market accounting—we submit to the Board that dire economic times require bold action. Indeed, while some at the Agency may view permitting the expense to be booked in this manner to be overly zealous, we are of the opinion that it falls soundly and reasonably within a fair reading of §202(a)(6)(C)(ii).

Namely, we believe that the application of GAAP in this situation would not be “appropriate,” since such an application would lead to a variety of negative consequences (e.g., previously unseen levels of negative earnings having a damaging effect on the confidence that members and the public have in the safety and soundness of credit unions) that could ultimately involve risk to the NCUSIF. Further, if the application of GAAP is deemed not appropriate, we believe that permitting the charging of these costs to Undivided Earnings would be “no less stringent” than GAAP, as the ultimate effect on credit unions' balance sheets would be the same—namely, net worth would be reduced on the balance sheet by the same amount that it would have been had the charge been expensed through the income statement. In other words, the financial statements (certainly the balance sheet and footnotes) would still present accurately and fairly the overall financial condition of the credit union. Also, such a deviation from GAAP would not compromise the safety and soundness of the Fund. Therefore, we suggest NCUA seriously consider this avenue, and challenge the Agency to provide its reasoning as to why this authority granted to it by the Act is being left unutilized during such a critical time.

Next, we strongly encourage the NCUA to utilize its regulatory authority to redefine the definition of “total assets” under §702.2(g) of the Prompt Corrective Action rule to exclude guaranteed or low/no-risk assets from net worth ratio calculations. This action would provide immediate relief in the following ways:

- It would allow credit unions to invest in no-risk assets and/or take certain assistance (e.g., loans from the CLF, asset purchase, guarantees, etc.), if necessary, without harming or diluting their net worth ratio.
- It would give many credit unions time to manage the multitude of challenging issues they currently face due to this once-in-a-lifetime economic crisis—which now includes the costs of the stabilization plan—without running afoul of PCA requirements.
- It would encourage additional credit union participation in the CU SIP program, therefore generating additional liquidity for the corporate system.

We applaud the NCUA for issuing guidance to examiners which includes instructions to recognize and allow for temporary reductions in ROA and net worth that result from credit union participation in the CU SIP program, and for recently taking action to amend its rule on the assessment of the federal credit union operating fee to exclude investments made under the CU SIP and CU HARP programs from the calculation of total assets. However, we believe it would provide more uniformity and reliability to formally make this redefinition via an amendment to the PCA regulation. If NCUA does take this reasonable and much needed step, then we would recommend that the following assets be excluded from “total assets” for the calculation of net worth:

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| • Cash   | • Accrued interest of non-risk investments        |
| • Overnight investments in corporate credit unions | • Loans purchased from liquidating credit unions  |
| • CU SIP deposits in corporate                     | • Assets held with options to sell to government  |
| • Corporate CU CDs                                 | • Loans under Corporate CU Loan Guarantee Program |
| • Insured institutional certificates of deposit    | • GNMA/FNMA/FHLMC (GSE) securities/bonds          |
| • Guaranteed student loans                         | • U.S. Treasuries                                 |
| • Share secured loans                              | • Furniture, fixtures, and equipment              |
| • Guaranteed portion of SBA loans                  | • Land and buildings                              |
| • Shares and loans guaranteed by the government    |   |
| • Other government/recourse loans                  |   |

## **Evaluating the Structure of the Corporate Credit Union System**

NCUA’s ANPR seeks input from all stakeholders in the credit union industry regarding reforms to the regulatory and functional structure of the corporate system. It is a sweeping reconsideration of the current role corporate credit unions play in the credit union system, including their charters, powers, investment authority, capital requirements, fields of

membership, risk management and governance. In our view, the ANPR takes an unnecessarily broad approach in that it assumes the current corporate system is flawed in virtually every respect, and therefore requires a complete retooling. While we fully acknowledge the serious stress that has been placed on the corporate system due to a variety of factors—some possibly foreseeable and preventable, some not—we do not agree that the current situation warrants what would amount to a wholesale remaking of corporates as they are known and used today. Therefore, rather than addressing the multitude of detailed questions in the ANPR, we would prefer to provide our views on the role of corporates in the credit union system, including our opinion of some of the key issues presented in the proposal.

### **The Role of Corporates**

Desert Valleys believe that the corporate system serves a vital role for credit unions. By serving as a central point for credit union investment and payment system services and aggregation, they provide many services that typically would be economically available only to the largest financial institutions (e.g., share draft processing, wire transfers, ACH services, cash orders, etc.). By managing liquidity within the credit union industry, corporates are able to effectively and efficiently move excess liquidity to the areas of greatest need. In addition, they provide the wherewithal to help credit unions manage risk, and are uniquely positioned to facilitate participation lending. Operational efficiencies and cost considerations prohibit many credit unions from obtaining these services directly from the Federal Reserve.

Without corporates, many credit unions would be largely dependent on more than one bank or bank-affiliated institution for these services, which would no doubt add significant additional costs and due diligence burdens to credit unions' operations, which would ultimately be passed on to members in the form of lower dividends or higher loan rates. We are reminded of the processing relationship (i.e., item processing, shared branching, and ATMs) that California credit unions had with Security Pacific Bank several years ago. When Security Pacific was merged with Bank of America, that relationship was severed by the bank over a six month period, which would have led to widespread dislocation and service collapse for California credit unions if WesCorp had not stepped in to pick up the item processing business and been instrumental in creating the business plan for Financial Service Centers Cooperatives (FSCC). Corporates have long maintained a necessary and trusted relationship with credit unions. Therefore, we strongly disagree with any action which would substantially alter the fundamental role and functions of the current corporate system.

### **Key Areas of Disagreement**

Our disagreement with the ANPR includes NCUA's contemplation to establish separate charters for payment system services and investments, as well as a return to defined fields of membership. We believe such a move would be anti-competitive and would hamstring the viability of the corporate system, likely leading to future problems requiring intervention by NCUA and/or natural person credit unions. Furthermore, not every corporate offers a full array of services (e.g., item-processing for imaged items). Restricting corporate usage to geographic fields of membership would unfairly and unsafely restrict credit unions from accessing critical corporate services. Along the same lines, the Leagues feel that a requirement that an "outside

director” be from entirely outside the credit union industry would be potentially damaging, and could serve to weaken the unique nature and philosophy of credit unions (and, frankly, we believe that such a requirement would not have prevented current circumstances).

### **Areas Where Improvements are Needed**

While we staunchly support the continuation of the corporate system, we feel there is room for greater efficiencies, more effective risk management in the system, and governance enhancements.

*Greater Efficiencies.* We believe that corporate consolidation would be beneficial to the system, and that NCUA should be more open, responsive, and supportive of such consolidation by removing unreasonable impediments and/or resistance to corporate credit union mergers. We realize that each tier of the corporate network takes its own share of income, adds another layer of cost, each has its own capital requirements, all of which reduces efficiency and effectiveness.

*More Effective Risk Management.* Recent events indicate that corporates require a larger capital cushion, a greater diversification of investment to include more restrictions on concentration risk, and more—or at least better—risk management tools. In addition, to provide an even more robust “firewall” between corporate credit union risk and natural person credit union safety, NCUA might consider the creation of a separate insurance fund or separate insurance “system” for corporate credit unions in the future. As the Federal Reserve and Treasury contemplate measures for reducing systemic risk, it will be important to recognize the *systemically important* role the corporate system plays in the nation’s “financial plumbing.” Ultimately, 90 million credit union members rely on the corporate system to provide trading, payments, clearing, and settlement services for their local credit unions. NCUA’s aim should be to assure that the credit union system as a whole is better able to withstand future shocks.

In closing, Desert Valleys would like to thank the NCUA Board for the opportunity to provide the views, concerns, and recommendations of natural person credit unions on the Agency’s unprecedented action. I cannot emphasize enough how critical it is that the Board seriously consider these views, which come from many of the credit unions hardest-hit by NCUA’s actions. We urge the Board to act to strike an effective and fair balance between the current needs of the corporate system and the very real, long-term, substantial needs of the entire credit union movement, and to strive for cooperation and transparency with credit unions in the process. We believe that to not do so will ultimately hurt public confidence in credit unions and the NCUA, and will be financially detrimental to American consumers.

Sincerely,

Eric A. Bruen  
President/CEO  
Desert Valleys Federal Credit Union